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Nos. 97-826, 97-829, 97-830 and 97-831

In the Supreme Court of the United States

OCTOBER TERM, 1997

AT&T CORP., ET AL.,

Petitioners,

v.

IOWA UTILITIES BOARD, ET AL.,

Respondents.

AT&T CORP., ET AL.,

Petitioners,

v.

CALIFORNIA, ET AL.,

Respondents.

AND RELATED PETITIONS

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

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BRIEF FOR CALIFORNIA IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the Eighth Circuit correctly concluded, in light of the mandatory rules of statutory construction contained in Section 2(b) of the Communications Act of 1934, as amended, and Section 601(c)(1) of the Telecommunications Act of 1996, that Congress intended to preserve the role of the States and the dual jurisdictional scheme for telecommunications regulation by conferring on the States authority over intrastate pricing, dialing parity and other requirements of the 1996 Act, except where the Act expressly confers authority over such intrastate requirements on the FCC.

2. Whether the Eighth Circuit correctly concluded that the FCC's "pick and choose" rule, which was stayed and later vacated by the Eighth Circuit because it impeded free and unfettered negotiation between incumbent local exchange carriers and competitive local exchange carriers concerning the terms and conditions of interconnection, is inconsistent with the language, purposes and structure of the 1996 Act.

3. Whether the Eighth Circuit correctly concluded that the FCC rule which would in all cases have required incumbent local exchange carriers to recombine on request unbundled network elements purchased by competitive local exchange carriers is inconsistent with the language, purposes and structure of the 1996 Act, where the rule would have permitted competitive local exchange carriers engaging in resale to avoid paying resale prices and where there exist numerous remedies under the Act to redress specific instances in which an incumbent local exchange carrier takes action which impedes competitive entry.

QUESTIONS PRESENTED – Continued

4. Whether when Congress enacts a dual jurisdictional scheme establishing separate spheres of authority for "expert" Federal and State regulatory agencies, the Federal agency is entitled to *Chevron* deference with respect to determinations it makes that are within the State agency's sphere of authority or that address the line between the two spheres of authority.

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STATEMENT OF CALIFORNIA

The People of the State of California and the Public Utilities Commission of the State of California (hereinafter collectively "California") are the sole State parties that challenged both the FCC's *First Report and Order*[1] and its *Second Report and Order*[2] and hence are the sole State respondents who prevailed in both Eighth Circuit cases below. California, which initiated its transition to local telephone competition in 1993, has an immense interest in bringing fair and effective local competition to its 32 million citizens as soon as possible. In addition, in California virtually *every* telephone call which is subject to the dialing parity rules contained in the *Second Report and Order* is intrastate in nature. California files this separate brief in opposition in both cases because of its unique interest and perspective.

STATEMENT OF THE CASE

Congress enacted the Telecommunications Act of 1996[3] to open all local telecommunications markets to competition. The Act established a set of duties with which incumbent local exchange carriers were required to comply and identified the functions, features and services that incumbent local exchange carriers were required to make available to competing local exchange carriers, as well as the mutual duties of carriers to each

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[1] Pet. App. 131a, *et seq.*

[2] Pet. App. 338a, *et seq.*

[3] Pub. L. No. 104-104, 110 Stat. 56 (Feb. 8, 1996), *codified at and amending* the Communications Act of 1934, 47 U.S.C. §§ 151, *et seq.*

other. 47 U.S.C. § 251.[4] It authorized carriers to negotiate agreements relating to the terms and conditions upon which interconnection, resale and the purchase of unbundled network elements would occur in order to allow the competing carrier access to the incumbent's network. § 252. To the extent that such negotiations were unsuccessful, it authorized State commissions to arbitrate and resolve disputes, and it permitted aggrieved carriers to appeal State commission determinations to Federal district courts. *Id.* Only if a State commission failed to carry out its responsibility under § 252 was the FCC empowered to "assume the responsibility of the State commission. . . . " § 252(e)(5).

The 1996 Act did not fundamentally alter the dual State/Federal jurisdictional scheme established by Section 2(b) of the 1934 Act, 47 U.S.C. § 152(b). By leaving § 2(b) intact when it passed the 1996 Act (with narrow and limited exceptions), Congress preserved the FCC's broad authority over "interstate" matters but also continued to fence off from FCC reach and regulation "intrastate" matters which fall within the exclusive authority of the States.

Nevertheless, with the enactment of the new law, the FCC saw opportunity. It issued its epic ***First Report and Order*** which tore asunder the dual jurisdictional scheme wrought by Congress by asserting FCC jurisdiction over intrastate matters that Congress reserved to the States, dictated a single methodology for the intrastate (and interstate) pricing of local competition services

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[4] Unless otherwise stated, statutory references are to the 1934 Act, as amended by the 1996 Act. *See* Note 3, *supra*.

nationally which it required the States to employ,[5] deputized the States to carry out its policies, and appointed itself the court of review of all State actions.[6] It simultaneously issued its similarly lengthy ***Second Report and Order*** which arrogated to itself the power to dictate to the States the standards for intraLATA dialing parity, even though almost every telephone call in the United States which is subject to those standards is intrastate in nature.[7]

Thirty-three States, along with other parties, challenged the FCC's opportunistic seizure of authority in the United States Court of Appeals for the Eighth Circuit. Some sought a stay of the FCC's pricing and "pick and choose" rules pending decision on the merits, and the Eighth Circuit granted the stay. *Iowa Utils. Bd. v. FCC*, 109 F.3d 418 (8th Cir. 1996). On motions to vacate the stay filed by the petitioners herein, which raised the very same arguments which they now raise in their petitions for certiorari (in many cases those arguments

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[5] It did so despite significant differences in evolving local markets and network investment, and in derogation of proceedings in numerous States, including California, which had begun the process of transitioning to local telephone competition several years before the 1996 Act was conceived.

[6] Pet. App. 30a-34a.

[7] The rules for interLATA or long distance dialing parity were established more than a decade ago following the AT&T divestiture, leaving the sole question the appropriate dialing parity rules for intraLATA calls (both local and toll). It was undisputed below that *no* measurable percentage of intraLATA calls (local and toll) associated with California LATAs is interstate in nature, and that nationally .002, or approximately 2 out of every 1000 intraLATA calls (local and toll), are interstate in nature. Moreover, a scant two per cent of intraLATA *toll* calls are interstate in nature.

are taken verbatim from their applications to vacate the stay), this Court unanimously declined to disturb the ruling, rejecting petitioners' claims that there was a "reasonable probability" that four members of the Court would vote to grant certiorari, a "significant possibility" of reversal of the Eighth Circuit's decision and "a likelihood" of irreparable harm arising from the decision. *See FCC v. Iowa Utils. Bd.*, 117 S. Ct. 378 (No. A-299 Oct. 31, 1996) (Thomas, J., in chambers), 117 S. Ct. 429 (No. A-299 Nov. 12, 1996) (per curiam).

After full briefing and argument, the Eighth Circuit rendered its final decision, fully consistent with its earlier stay ruling, vacating portions of the *First Report and Order* and associated FCC regulations. *Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997). Shortly thereafter, the Eighth Circuit rendered its final decision vacating portions of the *Second Report and Order* and associated FCC regulations. *California v. FCC*, 124 F.3d 934 (8th Cir. 1997). The court of appeals decisions restored the dual jurisdictional scheme, upholding State authority over intrastate pricing and dialing parity standards, and vacated the FCC's "pick and choose" rule. On rehearing in the *Iowa Utils. Bd.* case, the court of appeals also vacated the FCC's regulation requiring incumbent local exchange carriers to recombine unbundled network elements on the request of a competing local exchange carrier. Pet. App. 69a.

The decisions of the court of appeals cure the jurisdictional maladies of the FCC's orders, effectuate clear congressional intent, and engender a workable blueprint for the ongoing transition from regulation to local telephone competition.

These petitions for certiorari follow.

REASONS FOR DENYING THE PETITIONS

The Telecommunications Act of 1996 may be "an unusually important legislative enactment," *Reno v. ACLU*, 117 S. Ct. 2329, 2337 (1997), but that observation does not address the standards for this Court's exercise of its certiorari jurisdiction. In attempting to address those standards, the petitioners argue that certiorari should be granted because the Eighth Circuit's decisions are incorrect, there is a conflict between the circuits, and there may never be another opportunity for any court to address the issues presented.

a. The claim that the court of appeals' decisions are incorrect is unmeritorious. It was the FCC's *First Report and Order* and *Second Report and Order*, both of which usurped State authority over intrastate matters by reading § 2(b) out of the Act, that erred. Indeed, Congress considered including provisions that would have made § 2(b) inapplicable to the local competition portions of the Act but affirmatively deleted those provisions from the final version of the statute. *See* Pet. App. 18a n. 17. There is, however, no necessity for this Court's advertence to legislative history. Section 2(b) itself, which Congress left intact, is unambiguous in providing that "*nothing* in this chapter shall be construed to apply or to give the [FCC] jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service" (emphasis added). Thus, as the court of appeals correctly found, in the absence of clear statutory language overriding § 2(b) with respect to particular provisions of the 1996 Act, the section applies.

A further pronouncement of Congress also compels this view. In § 601(c)(1) of the 1996 Act (enacted and

signed into law but not codified), Congress provided: "This Act shall not be construed to modify, impair, or supersede Federal, State, or local law unless expressly so provided in such Act or amendments." This provision, which like § 2(b) is a mandatory rule of statutory construction, demonstrates that § 2(b), except where *expressly* modified, impaired, or superseded, remains in full force and effect. It also demonstrates that State authority to regulate intrastate telecommunications under *State* law, except where *expressly* modified, impaired, or superseded, similarly remains in full force and effect. The facial language of the statute accordingly supports the Eighth Circuit's conclusions. *Accord, Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 368-370, 374 (1986).

The petitioners press their claim that the so-called impossibility or inseverability exception to § 2(b), *see Louisiana*, 476 U.S. at 375-376 n. 4, precludes the applicability of § 2(b) to the local competition provisions of the Act. This argument is patently without merit. Not only was it *not* a stated basis for the FCC's decisions below, *see SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1943); *Burlington Truck Lines v. United States*, 371 U.S. 156, 168-169 (1962), but it is flatly refuted by the FCC's *ONA Reconsideration Order*, 5 FCC Rcd 3084 (1990), *reversed on other grounds sub nom. California v. FCC*, 4 F.3d 1505 (9th Cir. 1993), in which the FCC required, and the Ninth Circuit upheld, dual Federal/State tariffing of basic network elements, the very sort of network elements at issue in this case. 4 F.3d at 1513, 1515. The *ONA Tariffing* decision flies in the face of the new-found assertion by the FCC that Federal regulation of the intrastate component of unbundled network elements is compelled by necessity. Indeed, as noted by the

court of appeals below, ratemaking is inherently severable. Pet. App. 20a. This Court has agreed. *Louisiana*, 476 U.S. at 375.

Nor is there an inseverability issue with respect to dialing parity requirements, even though dialing parity does not involve rates. Again, the FCC did not rely on inseverability in the *Second Report and Order*. Moreover, the *Second Report and Order*, at ¶ 37,[8] itself acknowledges that dialing parity rules can be separated into interstate and intrastate components. In addition, the FCC's interest in imposing dialing parity rules which would apply to intraLATA calls which are 99.8 per cent intrastate in nature (100 per cent in California) is obviously *de minimis*. *See* Note 7, *supra*. Notably, in other contexts, the FCC itself has held that the Federal interest in regulating service which involves less than ten per cent interstate traffic is *de minimis*.[9] *Decision and Order, In the Matter of MTS and WATS Market Structure*, 4 FCC Rcd 5660 (1989), at ¶ 2, *adopting Recommended Decision and Order, In the Matter of MTS and WATS Market Structure*, 4 FCC Rcd 1352 (1989).

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[8] Paragraphs 31-96 of the *Second Report and Order*, which deal directly with the FCC's dialing parity requirements and the jurisdictional issue they implicate, are conspicuously absent from the Petitioners' Appendix. For the Court's convenience, California reproduces ¶ 37, which it has cited, in the appendix to this brief at App. 1-2.

[9] Approximately 92 per cent of all telephone calls made nationally are intrastate in nature. Statistics of Communications Common Carriers (FCC, 1994), at p. 22. Indeed, in 1993 there were nearly twice as many intrastate telephone calls made in California (68+ billion) as there were interstate calls made in the entire United States (38+ billion). *Id.* Thus the FCC's construction of the Act would leave a very thin interstate tail wagging a very substantial intrastate dog.

Finally, the FCC's inseverability claim ignores repeated holdings that the exception to § 2(b) is "a limited one." *California v. FCC*, 905 F.2d 1217, 1243 (9th Cir. 1990). Where such a claim is properly asserted, the FCC bears the burden, plainly not satisfied here, "of justifying its *entire* preemption order by demonstrating that the order is narrowly tailored to preempt *only* such state regulations as would negate valid FCC regulatory goals." *Id.* (emphasis in original); *accord, California v. FCC*, 75 F.3d 1350, 1359 (9th Cir.), *cert. denied*, 116 S. Ct. 1841 (1996) (FCC bears burden of demonstrating negation); *NARUC v. FCC*, 880 F.2d 422, 430 (D.C. Cir. 1989) ("The FCC has the burden . . . of showing with some specificity that [state regulation] . . . would negate the federal policy. . . . "). As noted, the FCC never even addressed inseverability in its orders below.

Nor is there merit to the claim that the Eighth Circuit erred in invalidating the FCC's "pick and choose" rule. The Court has already implicitly rejected that claim in upholding the court of appeals' stay of the rule. *Iowa Utils. Bd. v. FCC, supra*, 109 F.3d at 423. The Eighth Circuit correctly concluded below that by "discourag[ing] the give-and-take process that is essential to successful negotiations," Pet. App. 26a, the "pick and choose" rule "would thwart the negotiation process and preclude the attainment of binding negotiated agreements." *Id.* This commonsense proposition is obviously correct and hardly presents a weighty question worthy of the Court's review.

Nor is there merit to the claim that the Court should grant certiorari because the Eighth Circuit erred in invalidating the FCC's rule requiring incumbent local exchange carriers to recombine unbundled network elements on request. Pet. App. 70a-71a. The FCC regulation

invalidated by the Eighth Circuit would *in all cases* have permitted competitive exchange carriers engaging in resale to avoid resale prices and to purchase services for resale at unbundled network element prices, a possibility that could have severely undermined State pricing determinations under the Act. This, the Eighth Circuit concluded, "would obliterate the careful distinctions Congress has drawn in subsections 251(c)(3) and (4) between access to unbundled network elements on the one hand and the purchase at wholesale rates of an incumbent's telecommunications retail services for resale on the other." Pet. App. 71a. While the Eighth Circuit's invalidation of the FCC's regulation plainly has a well-reasoned basis, the question presented to this Court is merely whether the broad mandatory requirement of the FCC's regulation was valid, not whether States, under their authority to impose and enforce competitive cost-based pricing of access to unbundled network elements and resale, might permissibly impose a similar requirement in generic proceedings or individual adjudications. Indeed, long before the Eighth Circuit invalidated the FCC's regulation, the California Public Utilities Commission noted the issue and preserved the possibility of addressing it, should the Eighth Circuit so rule and this Court deny certiorari. *See Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks,* CPUC Rulemaking No. 93-04-003, ALJ Ruling (Mar. 4, 1997), at 9-12.[10] The State of Connecticut is presently considering the same issue. *See Application of*

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[10] *See* App. 3-7.

MCI Telecommunications Corp. for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996, Connecticut Dept. of Pub. Util. Control Docket No. 96-0909, Reply Letter of MCI dated Nov. 21, 1997.[11] In fact, MCI has represented to the Connecticut commission that the States of Ohio and Texas have already addressed the issue as a matter of State law. *Id.*

The methods which States may devise to deal with the two countervailing problems of a reseller's evading resale prices and an incumbent's provision of network access in a way that imposes undue costs on competitive entry are not yet before the Court. While it is hard to see how the Eighth Circuit's invalidation of the FCC's insufficiently considered regulation presents a question of monumental public concern, related issues which have in fact arisen in State commission arbitration and other proceedings may at some time present questions worthy of this Court's review. In any event, contrary to the petitioners' puffed arguments, it can hardly be said that the FCC's blunderbuss regulation is the *sine qua non* of local telephone competition.

Indeed, from the perspective of the States, the court of appeals gave the FCC far more than it deserved by according the agency's interpretation of the statute *Chevron* deference.[12] Pet. App. 8a. In the first place, *Chevron* deference is inappropriate where, as here, the statutory language is clear on its face. Even more importantly, however, when Congress enacts a dual jurisdictional scheme establishing separate spheres of authority for

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[11] *See* App. 8-13.

[12] *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984).

"expert" Federal and State regulatory agencies, the Federal agency must not be accorded *Chevron* deference with respect to determinations it makes that are within the State agency's sphere of authority or that address the line between the two spheres of authority. In such circumstances, according the Federal agency *Chevron* deference may give it a license to expand its authority beyond the limit intended by Congress.

That was precisely the situation in *Louisiana*, 476 U.S. at 374-375, where *Chevron* deference was *not* accorded to the FCC. The Court simply stated: "An agency may not confer power upon itself. To permit an agency to expand its power in the face of a congressional limitation on its jurisdiction would be to grant to the agency power to override Congress. This we are both unwilling and unable to do." This case, more than most, demonstrates that where a dual scheme is involved, *Chevron* deference is never appropriate because the agency receiving the deference may use it to upset the statutory balance established by Congress. *See, e.g., Northwest Central Pipeline Corp. v. Kansas Corp. Comm'n*, 489 U.S. 493, 512, 515-516 n. 12 (1989); *Altamont Gas Transmission Co. v. FERC*, 92 F.3d 1239, 1246-1248 (D.C. Cir. 1996), *cert. denied sub nom. Indicated Expansion Shippers v. FERC*, 117 S. Ct. 1568 (1997); *Clark v. Alexander*, 85 F.3d 146, 152 (4th Cir. 1996); *but see Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 380-381 (1988) (Scalia, J., concurring in the judgment) (suggesting that *Chevron* deference should extend to an agency's determination of the scope of its own authority). Stated another way, by retaining § 2(b) in the Act, Congress

legislatively determined that *Chevron* deference is inapplicable to the FCC's expansive determination of its own jurisdiction.

b. With respect to a purported conflict between the circuits, there is none. The Solicitor General effectively concedes this point by arguing that the Eighth Circuit's decisions "conflict *in principle* with the decisions of other federal circuits." FCC Pet. 11 (emphasis added). Indeed, the only cited court of appeals case which construes the 1996 Act is *Illinois Pub. Telecommunications Ass'n v. FCC*, 117 F.3d 555, 561-562, *clarified on other grounds on reh'g*, 123 F.3d 693 (D.C. Cir. 1997). FCC Pet. 17. That case holds that a provision of the 1996 Act "should not be read to confer upon the FCC jurisdiction over [intrastate matters] unless [the provision] is 'so unambiguous or straightforward so as to override the command of § 152(b).' " The jurisdictional rulings below are completely in harmony with this formulation, *compare id. with* Pet. App. 16a, and fully consistent with *Louisiana* and its progeny. There is simply no conflict.

c. Finally, the petitioners argue that certiorari should be granted because the Court will likely have no future opportunity to address the scope of the FCC's statutory authority. First, this assertion is speculative; there must be a *current* necessity for the Court's exercise of its certiorari power. Second, this Court has *already* looked at these questions and has rejected the very arguments raised in the petitions for certiorari in ruling on the applications to vacate the Eighth Circuit's stay of the pricing and "pick and choose" rules. Third, issues of preemption and jurisdiction under the 1996 Act have persistently arisen in appeals of FCC decisions, and there is no reason to suppose they will not continue to do so. *See, e.g., Iowa Utils. Bd. v. FCC, supra*, Pet. App.

1a-67a (appeal of FCC's *First Report and Order* under the 1996 Act); *California v. FCC, supra*, Pet. App. 73a-91a (appeal of FCC's *Second Report and Order* under the 1996 Act); *Illinois Pub. Telecommunications Ass'n v. FCC, supra*, 117 F.3d 555 (appeal of FCC's pay phone order under the 1996 Act); *Texas Office of Public Utility Counsel, et al. v. FCC* (5th Cir. Nos. 97-60421, *et al.* Pet. for Review filed June 25, 1997) (appeal of FCC's universal service order under the 1996 Act). Fourth, appeals from the rulings of the district courts on arbitration appeals pursuant to § 252(e)(6) will reach the courts of appeals, permitting unfettered review of jurisdictional issues raised in those proceedings despite the Hobbs Act, 28 U.S.C. § 2342(1).[13] And fifth, there is no reason to suppose that district courts will not defer to the Eighth Circuit's decisions if certiorari is denied. The question is not whether a denial of certiorari will deprive the Court of a future opportunity to address the issues in this case, but whether a grant of certiorari is presently necessary to settle those issues. It is not.

In the final analysis, this case is fundamentally the same as *Louisiana*. There, the FCC argued that "federal displacement of state regulation is justified under the Act when necessary 'to avoid frustration of validly adopted federal policies.' " 476 U.S. at 362, 363. In the face of this argument, the Court observed that "it goes without saying that we do not assess the wisdom of the asserted

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[13] Although AT&T attempts to bloat the importance of the issues by arguing that Federal district courts reviewing State commission arbitration decisions "should stay proceedings pending this Court's decision," AT&T Pet. 11, California is unaware of AT&T, MCI or the FCC requesting that *any* district court do so. Moreover, all three of those parties have appeared in numerous such district court cases and have filed pleadings *relying* on the Eighth Circuit's decisions on various issues.

federal policy of encouraging competition within the telecommunications industry. Nor do we consider whether the FCC should have authority to enforce, as it sees fit, practices which it believes would best effectuate this purpose." *Id.* at 359. The Court then rejected the FCC's argument, stating: "As we so often admonish, only Congress can rewrite this statute." *Id.* at 376.

Similarly here, the petitioners seek to justify the FCC's usurpation of State authority over intrastate matters based on the assertion that a construction of the statute displacing the role of the States is necessary to avoid the frustration of competition. FCC Pet. 24, 29-30. The petitioners' assertion is both false and irrelevant. It is false because, as the FCC acknowledged in both of its orders below, the States pioneered the shift from regulation to local competition long before the 1996 Act was conceived. Moreover, the States have consistently met and continue to meet their responsibilities under the Act. Thus, if "[i]ncumbent monopolists benefit enormously from any delay in opening their markets to competition," FCC Pet. 30, it is the FCC's overreaching, not any action or inaction by the States, that has spawned that result. Finally, the petitioners' assertion is irrelevant because here, as in *Louisiana*, and as correctly found by the court of appeals, the FCC's remedy lies with Congress, not this Court.

CONCLUSION

While the 1996 Act may be "an unusually important legislative enactment," the questions presented by these cases are half as important and twice as easy as petitioners would have the Court believe. The Court has previously rejected the same hyperbolic arguments in

ruling on the same petitioners' applications to vacate the Eighth Circuit's stay of the FCC's orders. Moreover, the Eighth Circuit's decisions are correct, they are fully consistent with congressional intent, and they provide a workable blueprint for the transition from regulation to local telephone competition under the 1996 Act. There is no conflict between the decisions below and the decisions of this Court or other circuits. Additionally, there is no necessity for this Court to address the jurisdictional questions, which it has already addressed in *Louisiana* and in its order denying the applications to vacate the stay. Finally, as competition moves forward, after the delay engendered by the FCC's jurisdictionally defective reading of the Act, this Court and other courts will have opportunities to address the 1996 Act, if and when the need arises.

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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December 12, 1997

APPENDIX

Second Report and Order, FCC 96-333, 11 FCC Rcd 19392, 19414 ¶ 37 (1996) (footnotes omitted.)

c. Discussion

37. With respect to toll service, we conclude that section 251(b)(3) requires, at a minimum, that customers be entitled to choose presubscribed carriers for their intraLATA and interLATA toll calls. Because of the variations that exist among LATA boundaries and toll traffic within, and among, the various states, we have also concluded that each state should have the opportunity to determine whether customers should be able to presubscribe to carriers for intrastate toll service and for interstate toll service in lieu of the intraLATA and interLATA toll presubscription dichotomy that we have established as a minimum nationwide standard at this time. Although toll dialing parity typically has been based on LATA boundaries in multi-LATA states where it has been implemented, we do not impose a requirement that toll dialing parity be based only on LATA boundaries given our expectation that implementation of the 1996 Act eventually will diminish the significance of LATA boundaries. We are aware that BOCs remain subject to certain LATA boundary restrictions for at least the near-term and that some BOCs may find it technically infeasible, or otherwise undesirable, to implement toll dialing parity based on state boundaries. We thus conclude that states should be able to take the relevance of those factors into account, where applicable, and have the flexibility to require that toll dialing parity implementation be based on state boundaries where they determine that implementing toll dialing parity on the basis of state

boundaries would be pro-competitive and otherwise in the public interest. In Alaska and Hawaii, states with no LATAs, toll dialing parity will continue to be based on state boundaries.

Excerpt from ALJ Ruling, Rulemaking No. 93-04-003 (Cal. Pub. Utils. Comm'n Mar. 4, 1997)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks.	)	(Filed Mar. 4, 1997)
	)	SAN FRANCISCO OFFICE
	)	No. R.93-04-003
	)	I.93-04-002
Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks.	)	

ADMINISTRATIVE LAW JUDGE'S RULING DECIDING ISSUES RAISED AT JANUARY 28, 1997 PREHEARING CONFERENCE, GRANTING ONE-WEEK EXTENSION OF TIME FOR FILING OPENING COMMENTS, AND SETTING SCHEDULE FOR PROCEEDING

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Should The Issue of "Arbitrage" Between Rates For Rebundled Network Elements And Rates For Wholesale Service Be Considered In the Pricing Hearings?

A second important question at the PHC [pre-hearing conference], which counsel for GTEC characterized

as "separate, although related" to the issue of "actual costs" (id. at 268), was whether hearing time should be allotted to the issue of rate "arbitrage." Pacific described the issue as follows on pages 2-3 of its January 22 PHC statement:

> "The FCC has ordered that CLCs be allowed to purchase and combine unbundled network elements together. In some instances, the combination of [unbundled network elements, or UNEs] can be used to create the same retail services which we offer for resale at a discount . . . In these situations, there is an opportunity for arbitrage if there is a difference between the price for the combined UNEs and the resale price for the retail service. This arbitrage has potentially large financial impacts, since key services vulnerable to this arbitrage include our basic exchange services, and our switched access services provided to interexchange carriers."

At the PHC, counsel for AT&T argued that since the potential for such arbitrage is inherent in the Telecommunications Act of 1996 (Act), the issue is "not legitimate" and a "red herring." Counsel for MCI explained how the potential for arbitrage arises from the different pricing standards for UNEs and wholesale service contained in the Act:

> "The Act clearly contemplates the kind of bottom-up TELRIC analysis, or some version of that, that the FCC and this Commission have pursued, [f]or what the FCC calls UNEs and what this Commission has called BNFs.

> "Conversely, the Act also clearly contemplates that the determination of an appropriate wholesale discount looks at the retail rate – the rate[,] not the cost – and then takes away from that avoided cost.
>
> "So if there is an [arbitrage] issue to be addressed . . . it may well be that that is what the Act itself contemplates." (1/28 PHC Tr. at 255.)

Counsel for GTEC responded with the observation that the Act's differing pricing standards cannot be considered the end of the debate:

> "Contrary to the comments of one of the parties, we're not seeking to change the pricing standards that have been set up under the Act. We recognize that there's two distinct standards.
>
> "However, I think that the Act as well as the FCC Order were silent when you came to the issue of how those two pricing standards interact.
>
> "And I agree with [counsel for Pacific] that if you have a situation where somebody can purchase the little [unbundled] pieces and combine them up at a lower price than the resale rate, essentially you're making [the wholesale] section of the statute meaningless; and I think that's not the way statutes are intended to be read." (**Id.** at 269.)

Upon reflection, I agree with Pacific and GTEC that the arbitrage issue is not necessarily inherent in the Act's two pricing standards, but arises out of the way in which

the FCC has interpreted § 251(c)(3) of the Act in its First Report and Order. This issue is hotly contested and is squarely before the Eighth Circuit in *Iowa Utilities Board*.[10] If the Eighth Circuit concludes that the FCC's interpretation of § 251(c)(3) is erroneous, then it seems likely that this Commission will have to deal with the arbitrage issue. If the Eighth Circuit concludes that the FCC's interpretation of § 251(c)(3) is correct, then barring an appeal to the Supreme Court, the arbitrage issue will presumably become moot. Either way, the prudent

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[10] The issue is framed as follows at pages 64-65 of the Brief of the Regional Bell Companies and GTE (Large LEC Brief) in *Iowa Utilities Board*:

> "Under section 251(c)(4), Congress imposed a distinct duty on incumbent LECs to provide retail services to requesting carriers at wholesale rates so that those carriers can resell the services to subscribers. Congress defined a distinct pricing standard for resold services, *see* § 252(d)(3), and expressly restricted the uses that can be made of them, *see* § 271(e)(1). The Order would nullify these provisions by construing section 251(c)(3) to give requesting carriers an entirely different avenue for reselling the incumbent LEC's own finished service, solely through the imaginary process of 'unbundling' the LEC's entire network and 'reassembling' the pieces. . . . The FCC's 'rebundle' rule in effect adds to the two options enacted by Congress (unbundled elements and resale) a third option that does not appear in the statute (rebundled elements). These rebundled elements can be exactly the same, in every respect, as the LECs' resold services, but they must be priced at rates much lower than those derived from the wholesale discount for resold services. This is not only contrary to the terms of section 251(c)(3), but also flatly contradicts the specific pricing standards and other restrictions that Congress crafted for limiting the reselling of services under the Act."

For a full discussion of this issue, see the following portions of the briefs in *Iowa Utilities Board*: Large LEC Brief at 64-69, FCC Brief at 99-106, Brief of AT&T et al. at 72-77, Large LEC Reply Brief at 42-45.

course of action is to allot hearing time on a provisional basis to consider the arbitrage issue, and then await developments. Accordingly, the revised procedural schedule attached to this Ruling as Appendix A includes an extra week of hearing time to deal with the arbitrage question.

* * *

/s/ A. Kirk McKenzie
A. Kirk McKenzie
Administrative Law Judge

Reply Letter Brief of MCI, *Application of MCI Telecommunications Corporation for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996,* Connecticut Dept. of Pub. Util. Control Docket No. 96-09-09 (Filed Nov. 24, 1997)

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November 21, 1997

(Received Nov. 24, 1997)

Via Federal Express

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Executive Secretary
Department of Public Utility Control
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Re: Docket No. 96-09-09 – Application of MCI Telecommunications Corporation for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996

Dear Secretary Murphy:

MCI Telecommunications Corporation ("MCI") submits this letter in response to the November 14, 1997 letter of the Southern New England Telephone Company ("SNET") in the above-referenced docket. SNET, in its letter, seeks to reopen the arbitration between the parties in order to modify certain provisions contained in the Agreement for Network Interconnection and Resale between SNET and MCImetro ("Agreement"). In particular, SNET requests that the Department of Public Utility Control ("Department") reopen the proceeding to modify the Warranties section (April 23, 1997 Errata, Section 13) as well as the provision regarding combinations of unbundled network elements (Agreement, Issue 16). SNET claims that the October 14, 1997 Eighth Circuit Court decision invalidates these provisions of the Agreement and therefore under the Regulatory Approvals section as well as the Governmental Compliance section[1] they should be renegotiated. MCI emphatically disagrees with SNET's position with respect to these provisions and believes that the provisions should not be modified and should remain in full force and effect. MCI requests that the Department deny SNET's request to reopen the arbitration proceeding and instead enforce the relevant provisions of the Agreement.

On October 21, 1997, SNET sent a letter to MCI requesting an opportunity to "renegotiate" the sections of the Agreement relating to combinations of unbundled elements and warranties due to the recent decision of the Eighth Circuit. SNET requested that MCI respond to its request by October 31, 1997. SNET indicated that if it

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[1] April 23, 1997 Errata at Section 2.2., Agreement, Governmental Compliance at p. 71.

did not receive a response from MCI by October 31, 1997, it would petition the Department to reopen the proceeding. MCI, by letter dated November 3, 1997, responded to SNET by stating that it was always available to discuss the parties relationship, but that the provisions of the Eighth Circuit decision cited by SNET do not require renegotiation of the Agreement.[2] On November 14, 1997, SNET filed its request with the Department to reopen the Agreement between the parties for the limited purpose described above.

SNET's request to renegotiate the Warranties section of the Agreement in light of the recent Eighth Circuit decision makes no sense. The Eighth Circuit decision has no bearing on the Warranties section contained in the Agreement and therefore should not be used as grounds to alter the provision. The Warranties section should stand as issued by the Department.

SNET provides no credible support for its request to renegotiate the provision of the Agreement pertaining to the combination of unbundled network elements.[3] SNET's legal argument in support of its request, that the

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[2] SNET in its November 14, 1997 letter to the Department, grossly mischaracterizes MCI's position by stating that MCI refused to negotiate "based on its position that the Eighth Circuit Court's Opinion *does not allow* for the reopening of the Agreement." (Emphasis added.) A quick reading of MCI's November 3, 1997 response shows that MCI took no such position. Rather, MCI stated that the Eighth Circuit decision *does not require* the Agreement to be renegotiated. MCI did, however, indicate to SNET in its November 3, 1997 response that it was available to discuss the parties relationship. SNET did not contact MCI.

[3] Issue 16 – Combinations of Unbundled Elements – provides in pertinent part "SNET shall provide MCIm, at MCIm's request, additional combinations of the unbundled elements which SNET has agreed to make available pursuant to this Agreement."

Eighth Circuit decision has interpreted Section 251(c)(3) of the Telecommunications Act of 1996 ("Act") to prohibit the incumbent local exchange carrier ("ILEC") from combining network elements upon request is patently incorrect. The Eighth Circuit found and held that the FCC's regulation that required ILECs to perform the combinations was inconsistent with the Act. The Act *does not* prohibit ILECs from voluntarily agreeing to perform element combinations – as SNET did[4] – and it likewise *does not* prohibit the state commissions from requiring the ILEC to do so as a matter of state law and policy. The limited legal effect of the Eighth Circuit opinion is the invalidation of the FCC's regulations mandating that ILECs perform the combinations.

Other state commissions have recently ruled on this issue. In Ohio, the Public Utilities Commission noted that the Eighth Circuit's October 14 decision "did not address state action under Federal Law or state action under state law." Further, the Ohio Commission found that the "Eighth Circuit's Order on rehearing notwithstanding, Ameritech's agreement through the give and take of an arm's length negotiation process, ***establishes an independent basis*** upon which to enforce the terms of the interconnection agreements. . . . " (emphasis added). Similarly, the Texas Public Utilities Commission has

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[4] On December 23, 1996, SNET submitted Revised Best and Final Offer language to the Arbitrator regarding the combination of unbundled elements (Issue 16). SNET's language did not object to the combination of unbundled elements instead, SNET agreed to provide such combinations of unbundled network elements and agreed to work with MCI to define the agreed upon time frame in which a combination would be made available and the priority in which a combination would be made available. SNET's December 23, 1996 Revised Best and Final Offers at p. 16. A majority of SNET's Best and Final Offer language is contained in the Agreement.

recently found that Southwestern Bell may not now refuse to provide combinations of elements even after the Eighth Circuit's order because Southwestern Bell had voluntarily agreed to provide such combinations in its interconnection agreement.[5]

In addition, the portions of the Agreement that SNET bases its request for renegotiation on, in particular; the Regulatory Approvals section and the Governmental Compliance section[6], do not support or justify its request. These provisions of the Agreement condone renegotiation when a provision is rendered unlawful or is invalidated by a subsequent court order or other legislative, regulatory or legal action. As noted above, the Eighth Circuit's invalidation of the FCC's regulation does not make the provision of the Agreement pertaining to combinations of unbundled elements unlawful nor does it invalidate that provision.

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[5] Similarly, in an earlier decision, not on the issue of combinations of elements, the New York Public Service Commission concluded that it would not interfere with those provisions arrived at through negotiations by the parties and that there is no legal requirement that the Commission amend those portions of an agreement. October 1, 1997 Order Approving Interconnection Agreement, Rejecting Portions Thereof, and Granting Reconsideration at pp. 5-6.

[6] Regulatory Approvals, Section 2.2 states in pertinent part "In the event . . . a court with appropriate jurisdiction issues orders, which make *unlawful* any provision of the Agreement, the parties shall negotiate promptly and in good faith . . . " (Emphasis added.) Governmental Compliance states in pertinent part "[I]n the event that legislative, regulatory, other legal action or changes in laws *invalidate* a material term(s) of this Agreement . . . the Parties shall attempt to renegotiate a new term(s) as may be required to allow this Agreement to continue." (Emphasis added.)

In conclusion, MCI requests that the Department deny SNET's request to reopen the arbitration in light of the recent Eighth Circuit Court decision for the purpose of renegotiating the Warranties provision and the provision regarding combinations of unbundled network elements. These provisions should not be modified and should remain in full force and effect.

Sincerely,

/s/ Kimberly A. Wild
Kimberly A. Wild

cc: Kathleen Carrigan